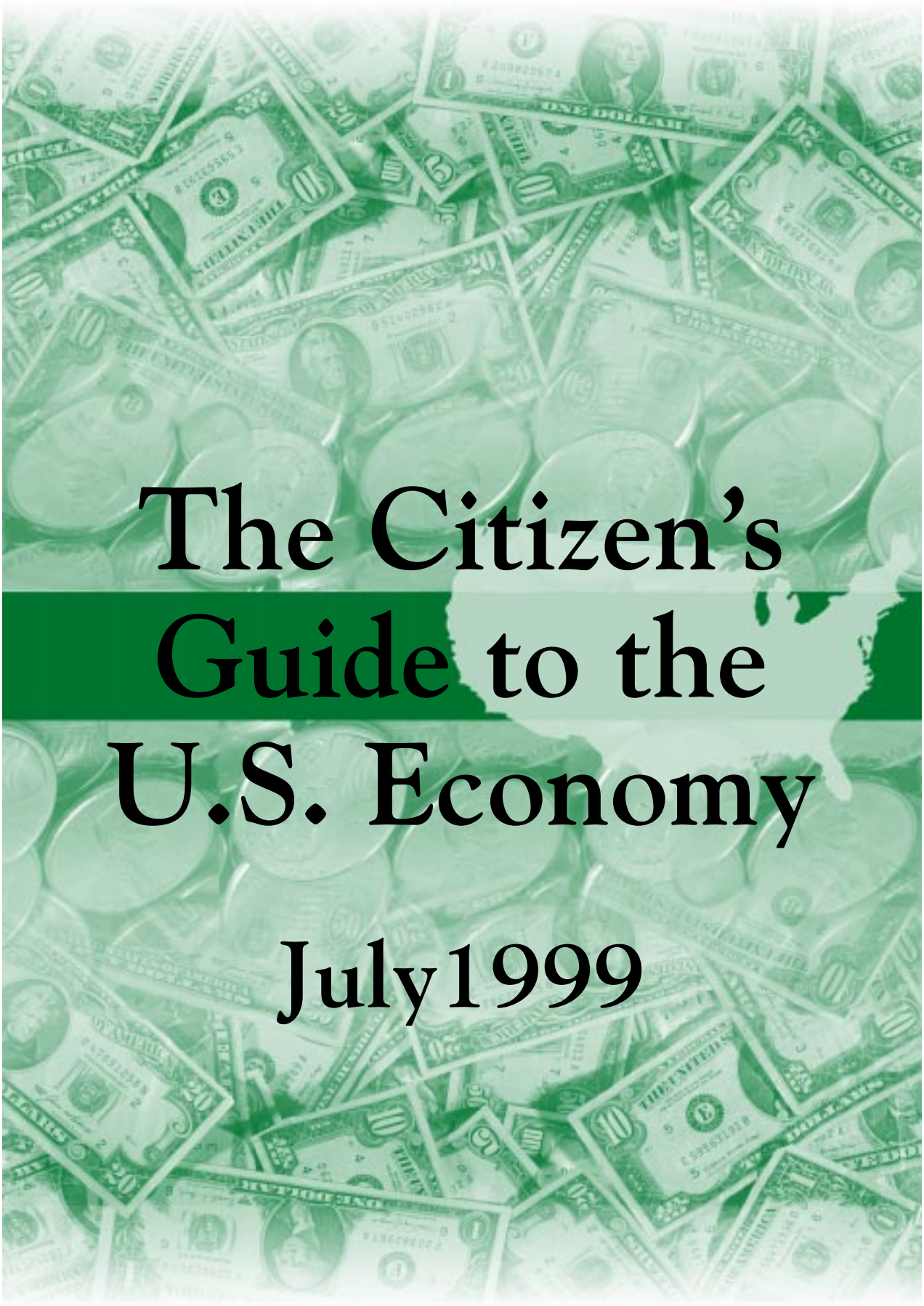


The Citizen's Guide to the U.S. Economy

July 1999

INTRODUCTION

Is the economy growing quickly or slowly? Are recent statistics good news or bad?

The Joint Economic Committee has drafted this Guide to provide a general overview of the economy and help non-economists make more informed judgments about statistical releases.

This Guide looks at ten essential economic topics to which people often refer. For each topic, the Guide offers a chart depicting the path of the economic statistic over a number of years. It also provides an explanation of what the statistic means.

These statistics are as follows:

- Gross Domestic Product
- Inflation
- Unemployment
- Mortgage Interest Rates
- Stock Market Performance
- Real Hourly Compensation
- Median Household Income
- Tax Rates and Tax Revenue
- Trade Deficits
- New Home Sales

If you have any questions or comments concerning this Guide, please feel free to contact Lawrence Whitman at (202) 224-0376.

** Because these statistics are often reported or revised on a monthly basis, the figures mentioned in each section may be slightly different from the more recent numbers available to you.*

TABLE OF CONTENTS

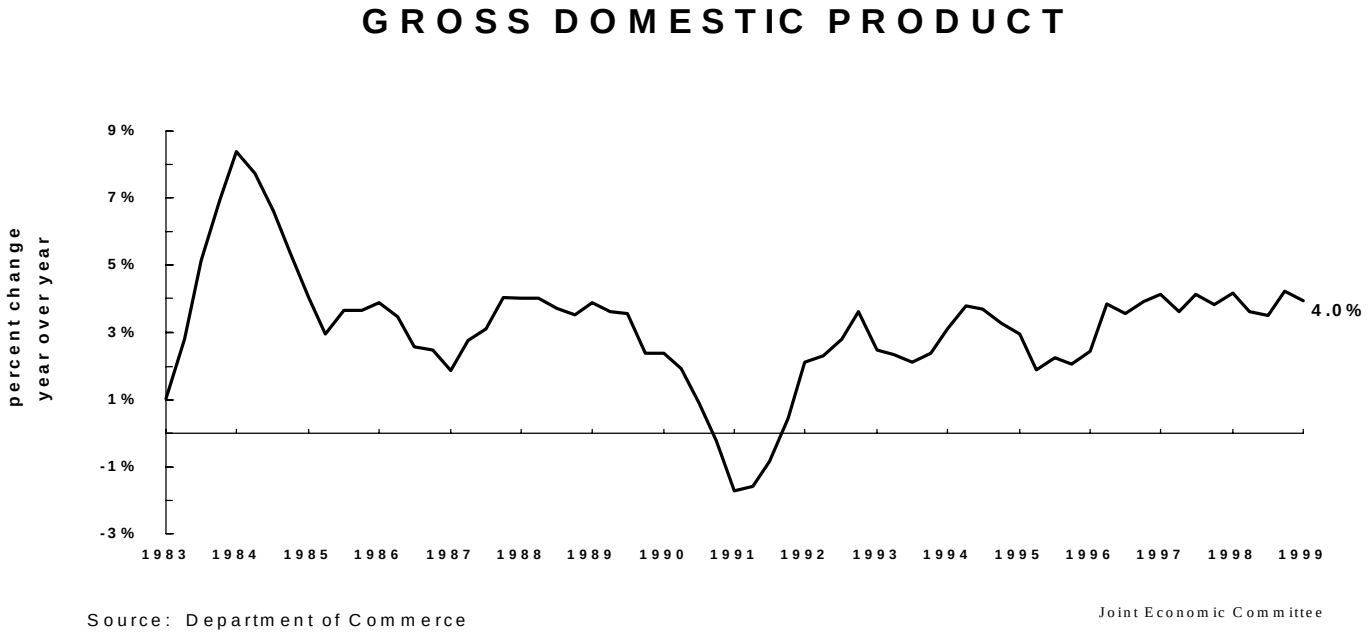
GROSS DOMESTIC PRODUCT

Gross domestic product (GDP) is the total value of goods and services produced during a given period (either a quarter or a year) in the United States. The Bureau of Economic Analysis, part of the Commerce Department, releases figures on GDP for each of the four quarters and for the year.

The most recent figure for GDP growth is 4.3% for the first quarter of 1999, adjusted for inflation. What does this 4.3% mean? The Commerce Department compares the amount of goods and services produced in the most recent quarter with the amount produced in the previous quarter. A growth rate of 4.3% means that if output keeps growing for a full year at the same rate it did from the fourth quarter of 1998 to the first quarter of 1999, then by the end of 1999 the economy would be 4.3% bigger. In other words, the economy did not grow 4.3% in the first quarter; rather, it grew at an *annual rate* of 4.3%.

The following chart shows something slightly different -- the path of GDP growth, *year over year*, since 1983. This means that each quarterly point represents how much the economy grew in the four quarters leading up to it. For example, for the year ending with the first quarter of 1999, the economy produced 4.0% more goods and services than in the same period one year before that.

During the most recent business cycle -- which includes the last recession in 1990-91 and the ensuing recovery and expansion -- GDP has grown at an annual rate of 2.6%. By contrast, the previous business cycle, which began with the 1981-82 recession and ended just before the current cycle, produced an annual growth rate of 3.1%.

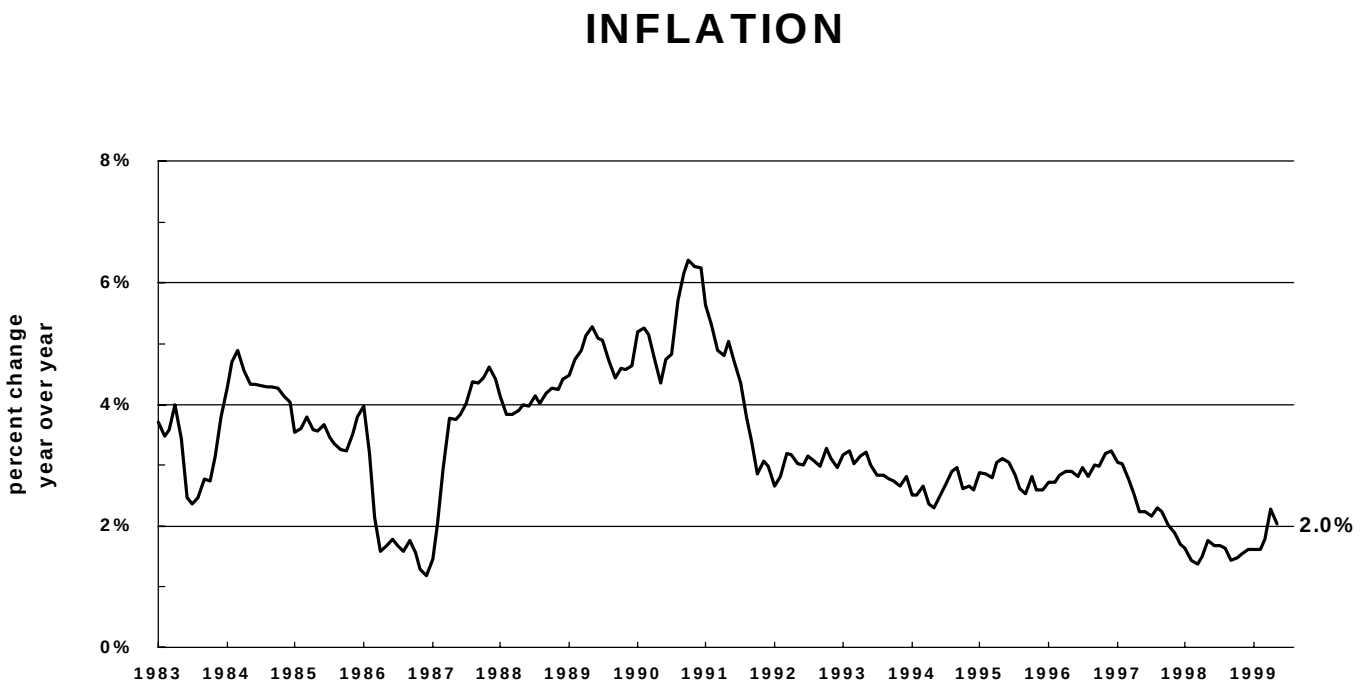


INFLATION

Most people think inflation means an increase in prices -- in other words, a decrease in the amount of goods and services they can buy with a fixed amount of money, for example, one dollar. In fact, the actual measure of inflation depends on which goods and services we watch for changes in prices. Perhaps the most closely followed inflation gauge is the Consumer Price Index (CPI) for urban workers. This index tracks the prices of goods and services purchased for consumption by urban households. Every month the Bureau of Labor Statistics, part of the Labor Department, releases data on changes in the CPI.

The most recent inflation figure is 0% for May. This means that from April to May consumer prices did not change. Because monthly data can be volatile, *year over year* changes in the CPI, as shown since 1983 in the following chart, are more instructive. Each monthly point shows the percentage change in the CPI in the year leading up to it. For example, consumer prices have risen 2.0% in the twelve months leading up to May 1999. During the entire period shown, consumer prices have risen at a yearly rate of 3.2%.

The 1990s have seen a move back toward the lower inflation rates the U.S. enjoyed before the 1970s. The average yearly increase in prices in the 1950s and 1960s was 2.4%. Inflation then climbed to an average of 7.4% in the 1970s. Inflation averaged 5.1% in the 1980s. So far this decade, prices have risen at a yearly rate of 2.8%.



UNEMPLOYMENT

The unemployment rate represents the share of people in the labor force not working. People are part of the labor force if they are either working or looking for work. When people cite the unemployment rate, they usually use the *civilian* unemployment rate, which excludes people in the military, all of whom have jobs. The Bureau of Labor Statistics (BLS) releases figures on the unemployment rate on the first Friday of each month.

The most recent unemployment figure is 4.2% for May. The following chart shows the path of the unemployment rate each month since 1983. The high point was 10.4% in both January and February 1983. The low point was 4.2% in both March and May of this year. The average unemployment rate during the whole period shown in the chart is 6.3%. In the 1950s and 1960s, the jobless rate averaged 4.6%.

The BLS actually takes two different surveys: the household survey and the payroll survey. The household survey gathers data by surveying people, household by household. Among other data, this sample yields the unemployment rate, which is based on the number of people who say they have jobs. By comparison, the payroll survey measures data the BLS gets from businesses about the number of people they have working for them. Among other data, this survey yields what is often quoted as the number of net new jobs each month, also known as the change in non-farm payrolls.

It is important to remember that the jobless rate reflects several factors, including the number of people without jobs, the number of people who want jobs, and the size of the labor force. If the labor force shrinks, the unemployment rate may fall even if the economy loses jobs. By contrast, a big leap in the labor force may overwhelm a gain in jobs, causing the jobless rate to move up. For example, in March 1996 the economy created 158,000 net new jobs. However, due to a rise in the labor force of 637,000, the jobless rate actually rose from 5.5% to 5.6%.

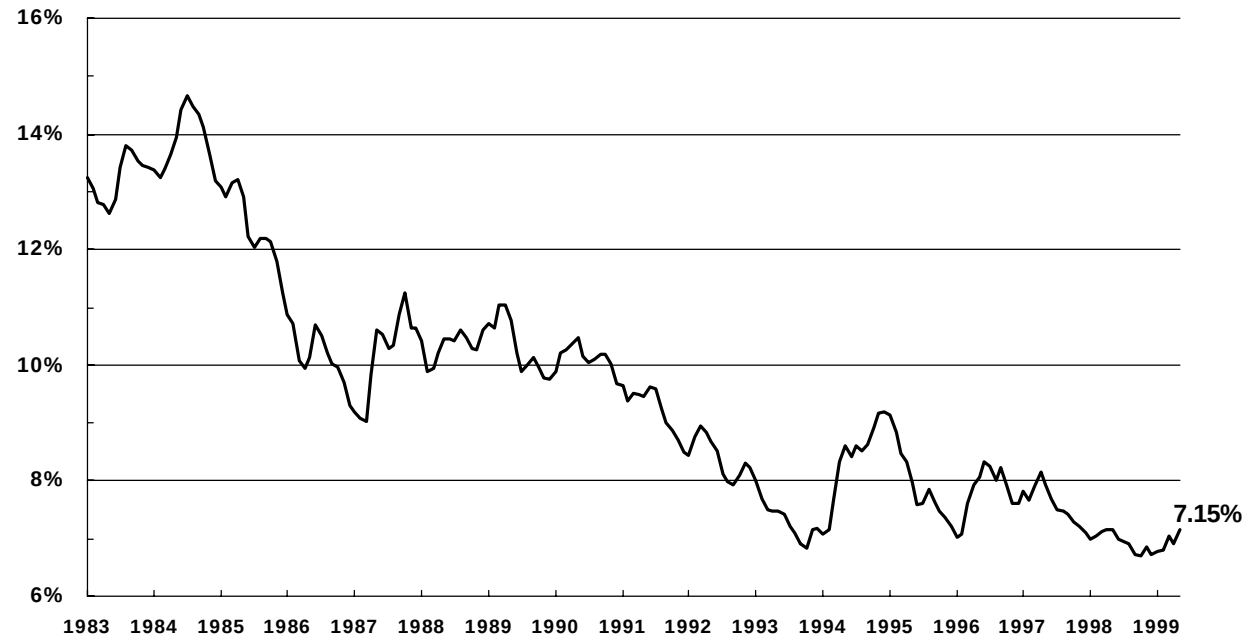
MORTGAGE INTEREST RATES

Mortgage interest rates are the rate of interest people have to pay on the money they borrow to buy their homes. Most often people borrow for terms of thirty years. A variety of groups, including the Federal Home Loan Mortgage Corporation and the Treasury Department, collect nationwide statistics on mortgage interest rates. The Federal Reserve Board compiled the figures noted here for first mortgages.

The most recent rate is 7.15% in May. That was the average for the month nationwide. The following chart shows the path mortgage interest rates have taken since 1983. The high point was 14.67% in July 1984. The low point was 6.71% in October 1998.

The long-term trend in mortgage rates includes two large declines: From a peak in July 1984 to a low-point in March 1987, rates dropped by about 5 1/2 percentage points. From May 1990 to October 1993, they fell by 3 2/3 percentage points. Both of these reductions lowered mortgage interest rates by more than one-third.

MORTGAGE INTEREST RATES



Source: Department of the Treasury

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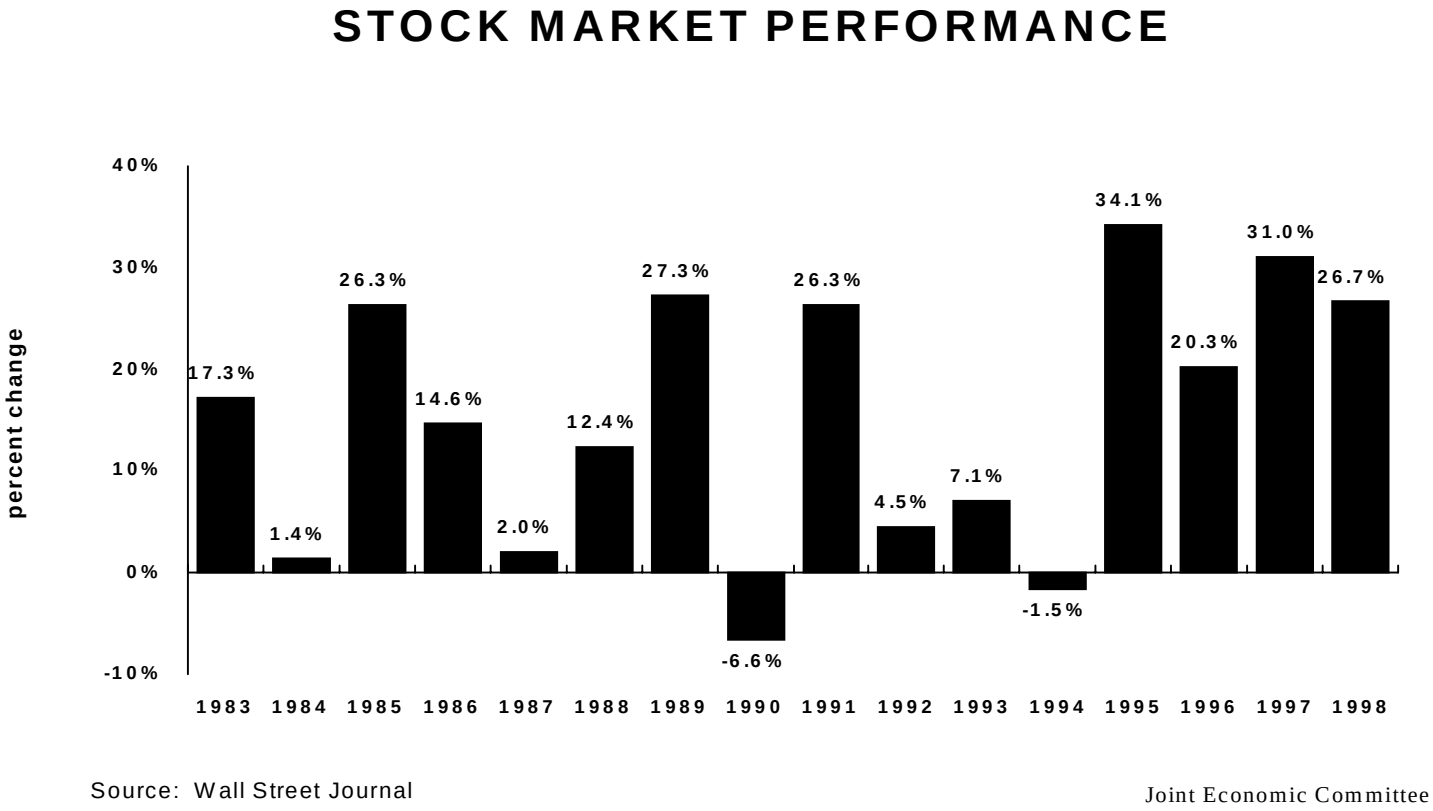
STOCK MARKET PERFORMANCE

The Standard & Poor's 500 index is a measure of the performance of the stock market that considers a wider range of companies than the Dow Jones averages. By measuring what people are willing to pay for shares of companies, the stock market is a good gauge of the future health of the economy.

In 1998 the S&P 500 rose 26.7%, as calculated by taking the year-end value for December 1998 versus the level for the end of December 1997. That followed increases of 31.0% in 1997, 20.3% in 1996, and 34.1% in 1995 — the biggest one-year rise since 1954 (38.1%). The following chart shows the percentage changes in the S&P 500 for each year since 1983. The worst year during this period was 1990, when the stock market dropped 6.6%. During the entire period the market increased at a yearly rate of 14.5% — more than 10% when adjusted for inflation.

Three prolonged periods mark the post-World War II era for the stock market. From 1950 through 1965, the S&P 500 rose at a yearly rate of 9%, adjusted for inflation. In the sixteen years after that, through 1981, it failed to keep pace with price increases, *falling* at an inflation-adjusted yearly rate of 4.8%. Since 1982, however, the S&P 500 has risen at an inflation-adjusted yearly rate of 10.9%.



Source: Wall Street Journal

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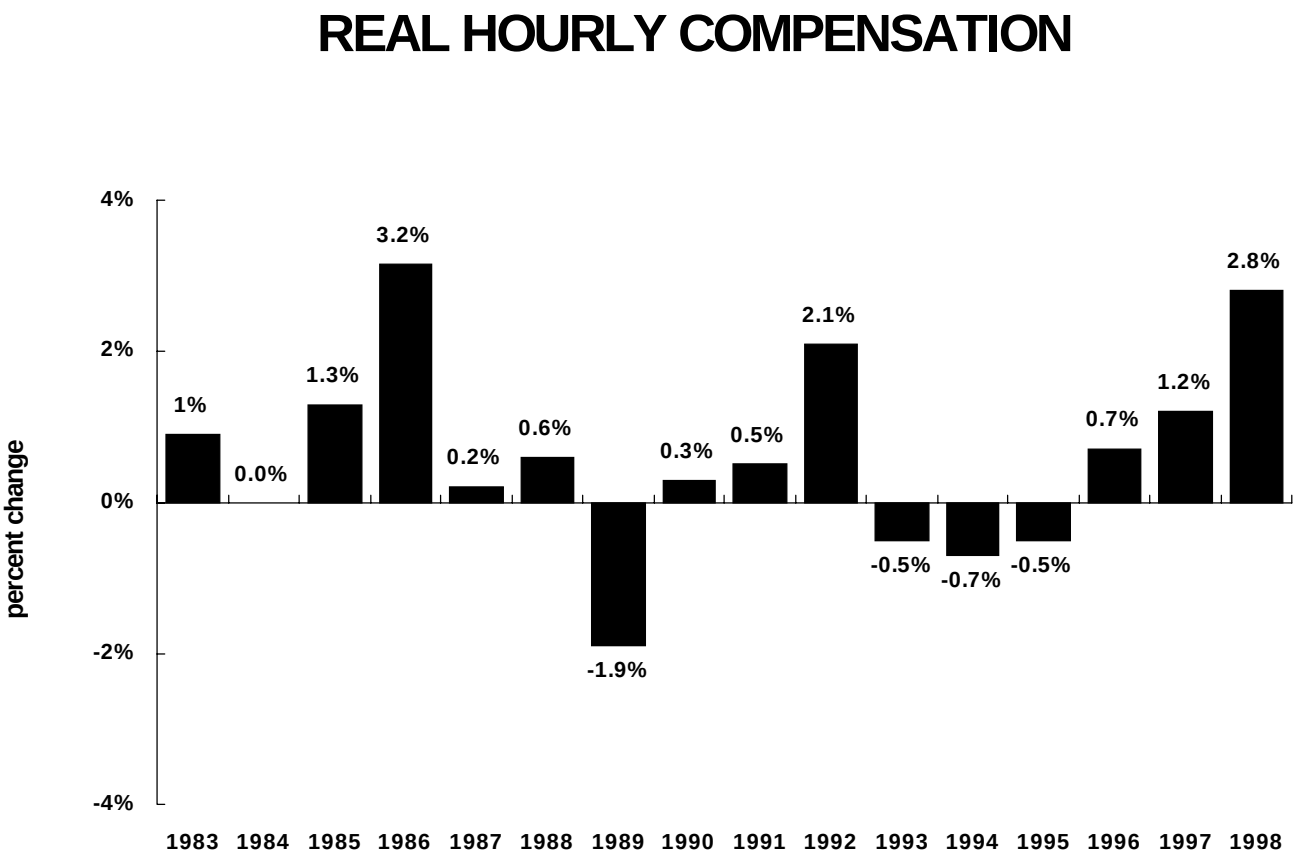
REAL HOURLY COMPENSATION

Real hourly compensation is how much workers earn per hour, adjusted for inflation. It includes not only the wages and salaries they get in their paychecks, but also the value of fringe benefits, such as health care. The Bureau of Labor Statistics (BLS) releases figures on real hourly compensation for each of the four quarters of the year.

The following chart shows the percentage change in real hourly compensation in each year since 1983. The biggest increase during this period was in 1986, when real hourly compensation increased 3.3%. The largest decrease was in 1989, when it fell 1.9%. Overall, from 1983 through 1998, real hourly compensation rose at a yearly rate of 0.6%.



Source: Bureau of Labor Statistics

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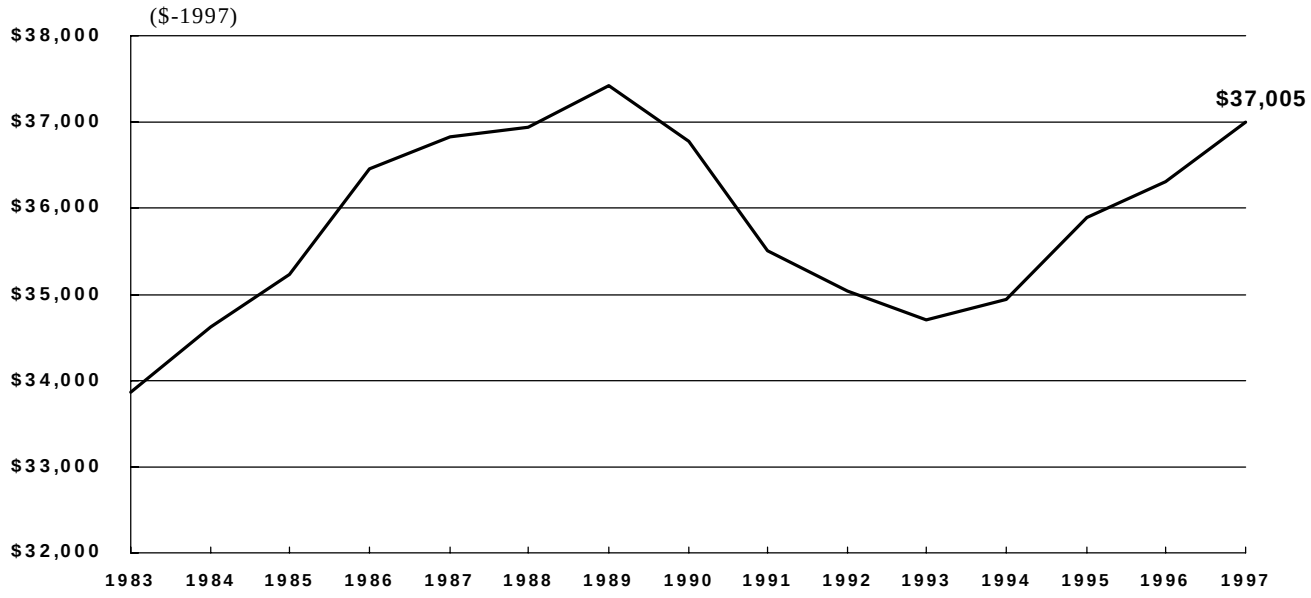
MEDIAN HOUSEHOLD INCOME

Real median household income is the income earned by a "typical" U.S. household, adjusted for inflation. The term "typical" refers to a household in the middle of the income scale, so that the number of households making more money than this "typical" household equals the number of households making less. In contrast to families, households include not only related individuals living in the same home, but also homes consisting of a single person or unrelated individuals. The Census Bureau, part of the Commerce Department, publishes statistics each year on median household income. New data for 1998 should come out this October.

The most recent figure is $37,005 for 1997. The following chart shows the path of median household income adjusted for inflation since 1983. As the chart depicts, median household income rose steadily after 1983, peaking in 1989. It then lost ground for four straight years. More recently, the trend has reversed, although real median household income has yet to return to the level of the 1989 peak. The average real median household income during the entire period shown in the chart is $35,834.

MEDIAN HOUSEHOLD INCOME



Source: Bureau of the Census

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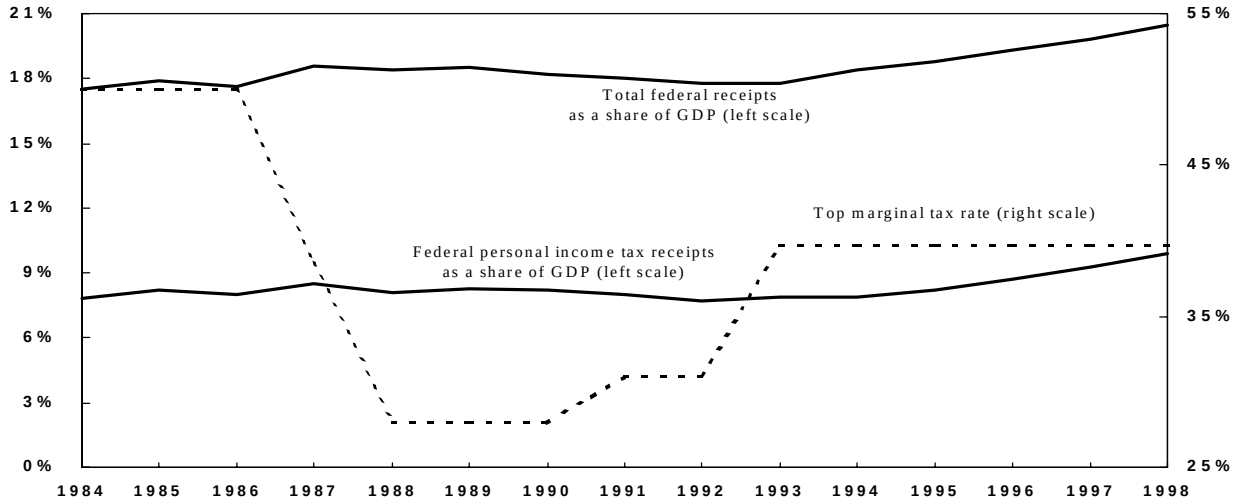
TAX RATES AND TAX REVENUE

The top marginal tax rate for individuals is the highest tax rate people pay to the federal government on their incomes. For example, since 1993, the federal government has taken 39.6% of any taxable income in the highest income bracket. Other tax rates apply to incomes below this level. These include rates of 0%, 15%, 28%, 31% and 36%. It is important to note that these income tax rates -- from 0% to 39.6% -- do not include payroll taxes (social security, medicare, etc.) paid by either workers or their employers.

The following chart shows the path of the top marginal income tax rate on individuals since 1983. During this period the top tax rate has varied widely, from a high of 50% between 1983 and 1986, to a low of 28% from 1988 through 1990. In 1986 the top 50% tax rate applied to taxable incomes above $175,250 (about $260,500 in 1998 dollars). In 1992 the top 31% rate applied to taxable incomes above $86,500 (about $100,500 in 1998 dollars). In 1998 the top rate of 39.6% applied to taxable incomes above $278,450.

From the end of World War II until 1993, the share of gross domestic product going to the federal government in the form of taxes was relatively stable and never exceeded 20%. As the chart shows, from 1983 until 1993, federal receipts as a share of GDP did not vary significantly and never even surpassed 19%. However, since 1993 federal taxes have consumed a larger proportion of GDP. In 1998 total federal tax receipts comprised 20.5% of GDP, the greatest proportion since the peak of World War II (20.9%) in 1944.
Similarly, from 1983 until 1993, the share of GDP going to the federal government in the form of individual income taxes was quite constant – varying only from a low of 7.7% in 1992 to a high of 8.5% in 1987. Since 1993, though, that proportion has steadily risen to 9.9%, the highest in our nation's history.

TAX RATES AND TAX REVENUES



Source: Department of the Treasury

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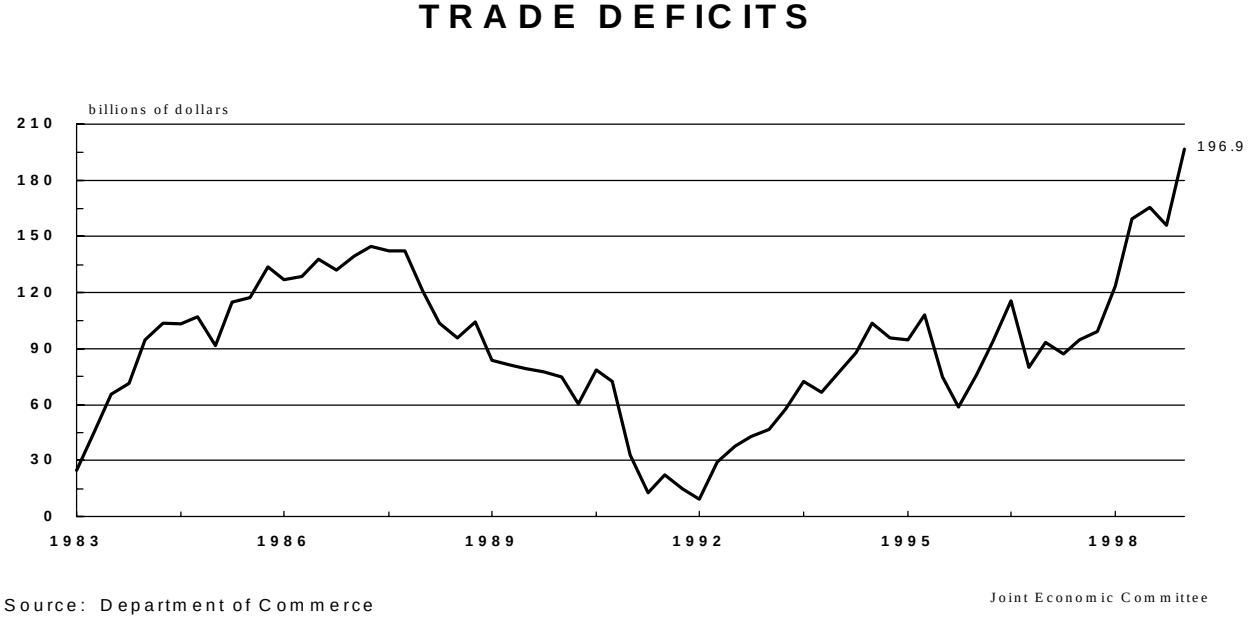
TRADE DEFICITS

There are a number of different ways to measure the trade deficit. For example, what is often reported as the trade deficit is really just the *merchandise* trade deficit -- the difference between the amount of goods the U.S. imports and the amount of goods it exports. This measure completely ignores the international flow of services -- such as legal work or investment advice -- in which the U.S. often has a surplus.

The trade deficit depicted in the following chart considers goods and services combined. The Bureau of Economic Analysis (BEA) releases this figure every three months. Each quarterly number is not the actual balance of trade for that quarter, but rather the balance for that quarter *at an annual rate*, as if this trade-deficit pace persisted for a full year. The most recent trade deficit, for the first quarter of 1999, was at a yearly rate of $196.9 billion. This figure represents the high point for the trade deficit since 1983. The low point was $8.9 billion for the first quarter of 1992. The average quarterly trade deficit since 1983 has been at an annual rate of $90.5 billion.

Despite the connotations attached to the term "deficit," a trade deficit is not necessarily something bad. It is important to note that economic growth and foreign investment both affect the trade balance. Foreign exchange markets establish a balance between exports plus investment of foreigners in the U.S. on the one hand, and imports plus American investment abroad on the other. Thus, the U.S. will tend to incur a trade deficit when our economy is growing rapidly – since it stimulates imports – and when the investment opportunities in the U.S. are more attractive than those abroad. Clearly, both rapid growth and attractive investment opportunities are signs of a healthy economy. Nonetheless, they will often lead to a trade deficit.



NEW HOME SALES

Each month the Census Bureau, part of the Commerce Department, releases data on the number of new one-family houses sold. It is important to note what this figure does not include -- namely, sales of existing homes and sales of multi-unit dwellings.

The most recent figure for new home sales was 978,000 in April. Does this mean that 978,000 new homes were sold in April? No. As with other government statistics, this figure is seasonally-adjusted and at an annual rate. A level of 978,000 means that if the April pace for selling new homes keeps up for a full year, then 978,000 new houses would get sold over a twelve-month period. However, this explanation is not exactly right either, because the numbers for each month are altered slightly to compensate for normal seasonal fluctuations in the number of homes sold. For example, if April is typically a strong month for home sales, then the Census Bureau will adjust figures for April so that this typical strength does not affect the numbers released. So, if the release for April shows strong sales, that means sales are greater than what we should normally expect for April, given its seasonal strength.

The following chart shows the path of new home sales, month-by-month since 1983. This means that each monthly point in time shows how many new one-family homes were sold that month, at a seasonally-adjusted annual rate. The high point during this entire period was in November 1998, when the figure hit 985,000. The low point was in January 1991, at 401,000. The average during this entire period is 681,000.

Changes in new home sales are sometimes a useful gauge for predicting short-term fluctuations in economic growth a few months ahead of time. Why? The sale of a new home usually indicates a near-term pick-up in purchases of other goods and services, such as furniture and appliances. While the sale of an existing home simply shuffles who lives where, the sale of a new home means more space overall for the kinds of goods and services homeowners buy.